



CITY OF DURHAM | NORTH CAROLINA

Date: August 16, 2011

To: Thomas J. Bonfield, City Manager
Through: Keith Chadwell, Deputy City Manager
From: Reginald J. Johnson, Interim Director
Department of Community Development
Subject: Approval of Public and Private Pre-Development Costs for the
Redevelopment of Southside Rental Phase I with McCormack Baron
Salazar Development, Inc. and Southside Revitalization Phase I LP

Executive Summary

On May 2, 2011 City Council approved a commitment of funding in support of Phase I of the Southside Revitalization project located on the former Rolling Hills site. On June 30, 2011, the North Carolina Housing Finance Agency (NCHFA) announced the award of 2011 Low Income Housing Tax Credits (LIHTC) to McCormack Baron Salazar (MBS) for the Southside project. To comply with Internal Revenue Service requirements, Phase I must be completed no later than December 2013.

In order to ensure that the required completion deadline is met, site preparation and infrastructure design as well as the design of the 132-unit Phase I project must begin promptly. The site preparation and infrastructure design will be funded by way of a Community Development Block Grant (CDBG) to MBS. The funding required is included in the funding commitment approved by Council at its May 2, 2011 meeting. The design of site improvements and the Phase I residential buildings themselves will be subsidized by a repayable predevelopment loan made with funds repaid to the City from prior housing bond loans. As with the CDBG grant, the loan amount is included in the approved total City subsidy commitment.

Currently, a Master Development Agreement (MDA) between the City and MBS is being drafted for consideration at a subsequent Council meeting. The major deal points of the MDA are outlined in the attached Term Sheet. Approval of the CDBG grant and predevelopment loan will allow design work on both the public and private fronts to proceed while the MDA is being finalized.

The Master Development Agreement (MDA) will be the overarching governing document that will specify the terms of all individual loans and grant agreements, the provision of the land, deeds of trust, promissory notes, budgets, development schedules, income guidelines, tenant eligibility, phase maps and any additional information that is integral to this project, and most specifically, the number and type of low and moderate housing units obtained in return for the City's subsidy. It will specify the responsibilities of the City and of MBS as the

project developer, including the terms for disbursement of funds during the pre-development and construction phases.

The CDBG contract will fund predevelopment activities for the entire site to include a phase I environmental assessment and geotechnical exploration and testing. It will also provide funding for site design to include civil engineering and landscape design and the preparation of bid documents for site preparation of the entire site to include mass grading and infrastructure improvements for phase I. MBS will earn a management fee of 16% or \$57,955.00 for the oversight of the phase I environmental assessment; the geotechnical exploration and testing and site preparation and infrastructure design.

The predevelopment loan will subsidize the private predevelopment activities to include architectural, civil, mechanical, plumbing and electrical design of the 132 unit multi-family complex, the payment of water and sewer impact fees, legal fees and the payment of the NCFHA allocation fee.

A right of entry agreement will allow MBS to enter on the City-owned site, and set out the terms for them to do testing and other work on the site, including such terms as liability and indemnification, as well as the obligation to return the site to its condition at the outset of the right of entry if MBS does not take title to the property by September 30, 2012.

Recommendation

The Department of Community Development recommends that City Council determine and find that mortgage loans for this housing project are not otherwise available, wholly or in part, from public or private lenders, upon equivalent or reasonably equivalent terms and conditions, authorize the expenditure of up to \$550,000.00 in CDBG funds for predevelopment activities, authorize the expenditure of \$998,300.00 in housing bond program income for the design of the 132-unit Southside Revitalization project Phase I, and authorize the City Manager to execute a CDBG contract with McCormack Baron Salazar Development, Inc. in an amount up to \$550,000.00, a housing bond program income predevelopment loan agreement with Southside Revitalization Phase 1 LP in an amount up to \$998,300.00, and a right of entry agreement.

Background

In December 2007, City Council accepted the recommendation of a review panel to select MBS as lead developer for Rolling Hills and portions of the adjacent Southside neighborhood. In the fall of 2009, a revitalization plan for the project area was prepared which identified three phases of rental development and three phases of homeownership development with the intent of serving a broad range of incomes while establishing the basis for future private investment. Subsequently, the Department was directed to craft a financing plan for the first two phases of both rental and homeownership development.

Issues/Analysis

On June 30, 2011, MBS was awarded \$1.3 million in tax credits annually for a period of 10 years which equates to approximately \$10,000,000.00 in equity or funding for about half of the project cost. Along with the award of 2011 federal tax credits, the IRS requires a completion or "placed in-service" date of no later than December 31, 2013. The 119 multi-family rental and 13 live/work units must be issued a certificate of occupancy from the City/County Building Inspections department by the in-service date. To ensure that deadline is met, predevelopment activities must begin by early October to allow the design team to complete environmental and geotechnical studies as prerequisites to the preparation of a site

plan for City approval and the creation of bid specifications for site preparation and infrastructure improvements.

Alternatives

The City Council could elect to not approve the agreements with MBS and Southside Revitalization Phase I LP. Without approval of the CDBG grant and the Pre Development Loan, the project would most likely not move forward and the tax credits would be forfeited.

Financial Impact

The financial impacts associated with the mutual commitments between the City and MBS were reviewed at special City Council meetings on the Southside Revitalization project held on March 10th and April 7th of this year. On May 2nd, Council voted to authorize the City Manager to issue a commitment letter to MBS to provide up to \$5,486,468.00 in loan funds for the first phase of mixed-income rental development on the Rolling Hills site and up to \$3,887,410.00 in grant funds for the associated site preparation and infrastructure.

The \$550,000.00 in CDBG funds for specified site activity will be drawn from prior years' funding available for reallocation and CDBG program income. Funding to subsidize the actual construction of the site preparation and infrastructure will be provided by way of the CDBG Section 108 loan.

The \$998,300.00 in housing bond program income for the predevelopment loan is budgeted and available in the Rolling Hills CIP (Capital Improvement Program). The funds are a part of the \$5,486,468.00 loan amount referenced above.

As part of the 2011 NCHFA tax credit application process, a requirement is the submittal of a project budget for review. Upon review of MBS budget, NCHFA made downward adjustments on several line items with the largest adjustment in rent up reserves and attorney fees. This created a potential gap in the proposed budgets of \$673,664.00. The gap could be closed by higher equity pricing or by way of value engineering. The last option would be for the City to provide 50% of the funding gap up to an amount of \$335,000.00. Whether a financing gap exists will not be known until agreements have been reached with respect to equity pricing and actual construction bids are received in mid-2012.

The proposed second phase of mixed-income rental development by MBS is subject to continued HOME entitlement funding.

As noted in the agenda memorandum associated with the Section 108 loan application, the General Fund would be impacted if the CDBG program was eliminated or substantially reduced, resulting in reliance on the General Fund as the source of loan repayment.

SDBE Summary

The Department of Equal Opportunity/Equity Assurance has met with representatives of MBS and are developing a SDBE Strategic Plan that will govern the participation of City-certified firms in all aspects of the scopes of work in this project.